

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 NEA-10 IO-13 EURE-00 CIAE-00 DODE-00
NSAE-00 NSCE-00 SSO-00 USIE-00 INRE-00 AGRE-00
SP-02 AID-05 EB-08 NSC-05 TRSE-00 SS-15 STR-04
OMB-01 CEA-01 PA-02 PRS-01 FRB-01 INR-07 XMB-04
OPIC-06 LAB-04 SIL-01 IGA-02 ISO-00 L-03 H-02
/119 W

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O R 301707Z MAR 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 2129
TREASURY DEPT WASHDC IMMEDIATE
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY NEW DELHI
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
AMCONSUL BELFAST
AMCONSUL EDINBURGH
USMISSION EC BRUSSELS
USMISSION OECD PARIS
USDEL MTN GENEVA
USDOC WASHDC

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DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD MARCH 24-30

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SUMMARY: DEMAND FOR STERLING CONTINUED TO BE STRONG AND
INTEREST RATES FELL AFTER THE CHANCELLOR'S BUDGET.
BANKING STATISTICS SHOWED ADVANCES TO U.K. RESIDENTS
GROWING BUT SLUGGISHLY. REAL DISPOSABLE INCOME, SAVING,
AND GROSS DOMESTIC FIXED CAPITAL FORMATION FELL IN THE
FOURTH QUARTER OF 1976. END SUMMARY.

1. STERLING CONTINUED TO STRENGTHEN DURING THE WEEK. FOREIGN EXCHANGE DEALERS POSTULATED THAT A BUDGET WHICH WAS WELL RECEIVED WOULD SEND STERLING ABOVE \$1.72. AND THEY WERE PROVEN CORRECT. STERLING WAS HELPED ON MONDAY BY POOR U.S. TRADE FIGURES, BUT ITS STRENGTH LATE TUESDAY IN LONDON AND NEW YORK AND ON WEDNESDAY IS ATTRIBUTABLE TO THE CHANCELLOR'S BUDGET. THE MARKET VIEWS THE BUDGET MESSAGE AS BASICALLY SOUND, A BIT OF A GAMBLE WITH THE UNIONS. BUT GOING IN THE RIGHT DIRECTION AND AIMING TO IMPROVE PERFORMANCE OF THE FUNDAMENTAL ECONOMIC FACTS OF LIFE. AS A RESULT, THE BANK OF ENGLAND CONTINUES TO LEAN AGAINST THE WIND, WITH SOME SPECULATION THAT NEXT WEEK'S RESERVE FIGURES WILL SHOW A MASSIVE INCREASE.

2. BANK ADVANCES TO U.K. RESIDENTS SLOWED IN THE BANKING QUARTER ENDED FEBRUARY 16, SHOWING A GROWTH OF ONLY 0.8 PERCENT OVER THE NOVEMBER 17 LEVEL COMPARED WITH 6.8 PERCENT GROWTH OVER THE PREVIOUS QUARTER AND 17.0 PERCENT GROWTH OVER THE LAST TWELVE MONTHS. THE FOREIGN CURRENCY COMPONENT OF BANK ADVANCES ROSE BUT 1.8 PERCENT OVER THE LATEST QUARTER COMPARED WITH 11.0 PERCENT OVER THE QUARTER ENDED NOVEMBER 17. AND 30.0 PERCENT OVER THE LAST TWELVE MONTHS. FOREIGN CURRENCY ADVANCES COMPRISE ALMOST 30 PERCENT OF TOTAL ADVANCES.

THE GROWTH PATTERN OF FOREIGN CURRENCY ADVANCES REFLECTS THE LARGE MOVEMENTS IN THE VALUE OF THE POUND OVER THE LAST YEAR. WHEREAS OVER THE LAST QUARTER BANK ADVANCES IN FOREIGN CURRENCY ROSE 181 MILLION POUNDS, AND OVER THE YEAR 2,372 MILLION POUNDS, AFTER THE BANK OF

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ENGLAND REMOVES THE ESTIMATED EFFECT OF EXCHANGE RATE MOVEMENTS THE INCREASES BECAME 475 MILLION POUNDS AND 990 MILLION POUNDS, RESPECTIVELY. THE POUND EXCHANGED FOR \$2.0245 ON FEBRUARY 18, 1976, \$1.6680 ON NOVEMBER 17, 1976 AND \$1.7070 ON FEBRUARY 16, 1977. THE 990 MILLION-POUND INCREASE WAS MAINLY ATTRIBUTABLE TO THE 360 MILLION-POUND INCREASE IN ADVANCES TO PUBLIC UTILITIES AND THE NATIONAL GOVERNMENT, THE 270 MILLION-POUND INCREASE TO "OTHER DISTRIBUTIVE SERVICES," AND THE 240 MILLION-POUND INCREASE IN MINING AND QUARRYING (WHICH INCLUDES OIL AND NATURAL GAS EXTRACTION).

THE DECELERATING GROWTH OF BANK ADVANCES REFLECTS

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SSO-00 INRE-00 AGRE-00 PA-02 PRS-01 IGA-02 L-03
H-02 /119 W

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O R 301707Z MAR 77
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TO SECSTATE WASHDC IMMEDIATE 2130
TREASURY DEPT WASHDC IMMEDIATE
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
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THE REDUCTION IN THE MONEY SUPPLY THAT THE MONETARY AUTHORITIES HAVE BEEN ABLE TO ACHIEVE DURING THE LAST QUARTER.

3. PERSONAL INCOME AND SAVINGS. FOURTH QUARTER DATA SHOW A SHARP DECLINE BOTH IN REAL DISPOSABLE INCOME AND UNCLASSIFIED

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PERSONAL SAVINGS. THERE WAS A DROP OF 3.3 PERCENT IN REAL DISPOSABLE INCOME DURING THE FOURTH QUARTER OF 1976 FROM A THIRD QUARTER FIGURE INFLATED BY AN INCOME TAX REBATE. IF THE THIRD AND FOURTH QUARTER FIGURES ARE

AVERAGED AND COMPARED WITH THE FIRST TWO QUARTERS OF 1976, A DECLINE OF 0.5 PERCENT AT AN ANNUAL RATE EMERGES. THIS DECLINE IS THE SAME AS THAT WHICH OCCURS WHEN FULL YEAR FIGURES FOR 1975 AND 1976 ARE COMPARED. THE SHARP FOURTH QUARTER SQUEEZE ON REAL INCOMES WAS PRODUCED BY SEVERAL FACTORS, MOST IMPORTANT OF WHICH WAS A RISE OF ONLY 0.7 PERCENT IN NOMINAL WAGES AND SALARIES. THESE ACCOUNT FOR ABOUT 60 PERCENT TOTAL PRE-TAX INCOME, WHILE INCOME FROM SELF EMPLOYMENT AND "RENT, DIVIDENDS AND INTEREST" WHICH ROSE BY 4.5 PERCENT DURING THE FOURTH QUARTER MAKE UP ABOUT 30 PERCENT OF PRE-TAX INCOMES. AS A RESULT, TOTAL PRE-TAX INCOME ROSE BY 2.1 PERCENT. BECAUSE OF SHARPLY PROGRESSIVE MARGINAL INCOME TAX RATES' NOMINAL DISPOSABLE INCOME ROSE BY ONLY 0.2 PERCENT. THIS RISE WAS HARDLY SUFFICIENT TO OFFSET AN INCREASE OF 3.6 PERCENT IN THE CONSUMER EXPENDITURE DEFLATER.

THERE WAS ALSO A SHARP DECLINE IN PERSONAL SAVINGS DURING THE FOURTH QUARTER WITH THE SAVINGS RATIO DECLINING FROM 15.5 PERCENT OF DISPOSABLE INCOME IN THE THIRD QUARTER TO 11.6 PERCENT IN THE FOURTH. THIS IS THE LOWEST QUARTERLY PERCENTAGE SINCE 1973. BY REDUCING SAVINGS BY 844 MILLION POUNDS DURING THE FOURTH QUARTER THE CONSUMERS WERE ABLE TO FINANCE AN 890 MILLION POUND RISE IN NOMINAL SPENDING (1.1 PERCENT IN VOLUME TERMS). A LARGE PART OF THIS INCREASE MIGHT BE ATTRIBUTED TO ANTICIPATORY PURCHASING OF CONSUMER DURABLES AND WINE AND WHISKEY AHEAD OF INCREASES IN VALUE ADDED AND EXCISE TAXES RUMORED TO BE A PART OF THE CHANCELLOR'S DECEMBER MINI-BUDGET. THE SQUEEZE ON REAL INCOMES PROBABLY WILL CONTINUE DURING THE FIRST QUARTER OF 1977. PARTIAL DATA INDICATE THAT EARNINGS HAVE RISEN MORE SLOWLY THAN PRICES. HOWEVER, EARLY 1977 RETAIL SALES VOLUME DATA

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INDICATE THAT TOTAL CONSUMER EXPENDITURE VOLUME MAY WELL BE DECLINING FROM FOURTH QUARTER LEVELS. IF SO, THE 11.6 PERCENT SAVINGS RATIO MAY HAVE BEEN AN EXAGGERATED INDICATION OF A DECLINING TREND IN CONSUMER SAVINGS.

4. THE FINANCIAL MARKETS WERE QUIET THROUGH MOST OF THIS WEEK. WITH ONLY THE SHORTEST RATES SHOWING SIGNIFICANT DECLINES. ON WEDNESDAY, FOLLOWING THE BUDGET MESSAGE AND STRONG CAPITAL INFLOWS FROM OVERSEAS, INTEREST RATES DROPPED SHARPLY. SHORT-TERM RATES FELL BUT A QUARTER OF A PERCENT, BUT GILT PRICES ROSE OVER TWO POINTS IMPLYING A FALL IN REDEMPTION YIELDS OF NEARLY 1/2 PERCENT. THE MAJOR CLEARING BANKS BEGAN TO LOWER THEIR BASE LENDING RATES FROM 10-1/2 TO 9-1/2 PERCENT AND THEIR DEPOSIT RATES FROM 6-1/2 TO 5 PERCENT. A SPOKESMAN FOR THE NATIONAL WESTMINSTER BANK SAID THAT IN SPITE OF THE 1 PER-

CENT REDUCTION IN ITS BASE LENDING RATE A FORTNIGHT AGO, DEMAND FOR BANK ADVANCES CONTINUED TO BE DEPRESSED, AND THE BANK'S RESOURCES CLEARLY EXCEEDED THEIR CURRENT REQUIREMENTS.

5. THE CHANCELLOR'S BUDGET, PRESENTING MAXIMUM NET TAX CUTS OF 1.5 BILLION POUNDS CONTINGENT ON ACHIEVING A SATISFACTORY PAY POLICY. WAS PRESENTED MARCH 29. THE PRESENTATION WAS POLITICALLY KEYED. AND PRESENTED NO MAJOR SURPRISES. (SEE LONDON 5179, 5180, 5181 AND S206.)

6. CAPITAL EXPENDITURE. FOURTH QUARTER GROSS DOMESTIC FIXED CAPITAL FORMATION DECLINED BY 3.2 PERCENT WHILE INVENTORY ACCUMULATION INCREASED SHARPLY. AFTER REMAINING UNCHANGED BETWEEN THE SECOND AND THIRD QUARTERS, FIXED INVESTMENT DECLINED BY 76 MILLION POUNDS IN 1970 PRICES TO 2.316 BILLION POUNDS IN THE FOURTH QUARTER. THE BULK OF THE DECLINE OCCURRED IN "MINING AND QUARRYING". HOWEVER, INVESTMENT IN MANUFACTURING INDUSTRY ROSE BY 1.0 PERCENT, CONTINUING A SERIES OF QUARTERLY INCREASES WHICH BEGAN IN THE SECOND QUARTER OF 1976. FULL YEAR COMPARISONS REVEAL UNCLASSIFIED

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THAT FIXED INVESTMENT FELL BY 4.3 PERCENT IN 1976 TO 9.562 BILLION POUNDS IN 1970 PRICES. MANUFACTURING INVESTMENT WHICH ACCOUNTS FOR ABOUT AN EIGHTH OF THIS TOTAL DECLINED BY 5.0 PERCENT TO 1.65 BILLION POUNDS AND CURRENTLY STANDS AT 18.5 PERCENT BELOW ITS 1974 LEVEL OF 2.024 BILLION

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SSO-00 INRE-00 AGRE-00 PA-02 PRS-01 IGA-02 L-03
H-02 /119 W

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POUNDS. INVENTORY INVESTMENT AMOUNTED TO 109 MILLION
 POUNDS (1970 PRICES) DURING THE FOURTH QUARTER BRINGING
 THE TOTAL INCREASE FOR 1976 TO 19 MILLION POUNDS. THE
 LARGE 192 MILLION-POUND DECLINE IN THE SECOND QUARTER
 NEARLY OFFSET THE INCREASES IN STOCKS WHICH OCCURRED OVER
 THE REMAINDER OF THE YEAR.

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7. EXCHANGE RATE AND GOLD EFFECTIVE

EXCHANGE RATE

EXCHANGE PERCENT(DEC.1971 GOLD

DATE	RATE (\$)	EQUALS 100)	(\$)
3/23	1.7180	61.7	153-5/8
3/24	1.7180	61.8	152-5/8
3/25	1.7177	61.8	153-5/8
3/28	1.7187	61.8	149-7/8
3/29	1.7192	61.8	147.7/8

CHANGE 3/22-3/29 UP 0.0030 UNCHANGED DOWN 3

8. FORWARD DISCOUNT ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/23	0.92	2.72	5.17
3/24	0.85	2.40	4.88
3/25	0.85	2.45	4.88
3/28	0.75	2.32	4.72
3/29	0.70	2.15	4.40

CHANGE 3/22-3/29 NAR.0.35 NAR. 0.70 NAR 1.15

(ALL FIGURES IN CENTS)

9. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/23	4-5/8	5-1/8	5-1/2
3/24	4-7/8	5-1/8	5-1/2
3/25	5-1/8	5-1/4	5-5/8
3/28	5-1/4	5-1/4	5-5/8
3/29	5-1/4	5-3/8	5-5/8

CHANGE 3/22-3/29 UP 3/8 UP 1/8 UNCHANGED

10. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST RATE DIFFERENTIAL

DATE	
3/23	4-13/16
3/24	4-13/16

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3/25	4-5/8
3/28	4-7/16
3/29	4-9/32

CHANGE 3/22-3/29 NARROWED 13/32

L1. STERLING CERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
3/23	10-1/16	9-13/16	9-25/32
//24	10-3/16	9-3/4	9-45/64
3/25	10-1/16	9-5/8	9-5/8
3/28	9-31/32	9-1/2	9-7/16
3/29	9-11/16	9-7/16	9-13/32

CHANGE 3/22-3/29 DOWN 3/8 UP 1/32 UNCHANGED

12. THE MINIMUM LENDING RATE REMAINED AT 10-1/2 PERCENT AS THE BANK OF ENGLAND ONCE MORE OVERRODE THE MARKET BASED FORMULA. THE TREASURY BILL RATE FELL 0.0070 PERCENT TO 9.3513 PERCENT AT THE MARCH 25 AUCTION WHICH WOULD HAVE IMPLIED A 10 PERCENT MLR AS CALCULATED BY THE FORMULA. THE 500 MILLION-POUND TENDER ATTRACTED BIDS OF 1.293.3 MILLION POUNDS. THIS WEEK 500 MILLION POUNDS IN TREASURY BILLS WILL BE OFFERED AS 300 MILLION MATURE.

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